



Senate

General Assembly

File No. 453

January Session, 2005

Substitute Senate Bill No. 1265

Senate, April 20, 2005

The Committee on Finance, Revenue and Bonding reported through SEN. DAILY of the 33rd Dist., Chairperson of the Committee on the part of the Senate, that the substitute bill ought to pass.

AN ACT CONCERNING PENALTIES FOR FAILURE TO REPORT LISTED TRANSACTIONS.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. (NEW) (*Effective from passage and applicable to any open tax*
2 *period*) A penalty is hereby imposed on every person who engages in
3 activities described in Section 6700(a) of the Internal Revenue Code of
4 1986, or any subsequent corresponding internal revenue code of the
5 United States, as from time to time amended, and who is subject to the
6 fifty per cent penalty imposed thereunder, whether or not such penalty
7 has been imposed, where such activities affect tax returns required to
8 be filed with the Commissioner of Revenue Services. The amount of
9 the penalty imposed hereunder shall be equal to fifty per cent of the
10 gross income derived from, or to be derived from, such activities by
11 such person.

12 Sec. 2. Section 12-233 of the general statutes is repealed and the

13 following is substituted in lieu thereof (*Effective from passage and*
14 *applicable to income years commencing on or after January 1, 2005*):

15 (a) (1) The commissioner shall [, (1)] examine the tax return filed
16 under this chapter by a taxpayer and may make such further audit or
17 investigation as the commissioner deems necessary, and if the
18 commissioner determines that there is a deficiency with respect to the
19 payment of any tax due under this chapter, the commissioner shall
20 notify the taxpayer thereof. Except as otherwise provided in this
21 section, the commissioner shall (A) in the case of a return on which an
22 operating loss is not reported, [within] not later than three years after
23 the due date for the filing of such return or [within] not later than three
24 years after the date on which such return was received by [him] such
25 commissioner, whichever period expires later, or [(2)] (B) in the case of
26 a return on which an operating loss is reported, [within] not later than
27 three years after the due date or the date of receipt by the
28 commissioner, whichever period expires later, of the return on which a
29 carry-over of such loss is fully utilized or deemed fully utilized
30 because such loss is not available for deduction in any subsequent
31 income year, examine it and, in case any error is disclosed by such
32 examination, shall [,within thirty days after such disclosure, notify the
33 taxpayer thereof] mail a notice of deficiency assessment to the
34 taxpayer. Where, within the sixty-day period ending on the day on
35 which the time prescribed in this section for mailing a notice of
36 deficiency assessment for any income year would otherwise expire, the
37 commissioner receives a written document signed by such taxpayer
38 showing that such taxpayer owes an additional amount of tax for such
39 income year, the commissioner then shall have up to sixty days after
40 the day such written document is received in which to mail a notice of
41 deficiency assessment.

42 (2) A notice of deficiency assessment may be mailed to the taxpayer
43 at any time in the case of (A) failure to file a return, including any
44 amended return required pursuant to section 12-226, or (B) a
45 deficiency due to fraud or intent to evade the provisions of this chapter
46 or regulations promulgated thereunder.

47 (3) In the case of an omission from gross income of an amount
48 properly includible therein that is in excess of twenty-five per cent of
49 the amount of gross income stated in the return, a notice of deficiency
50 assessment may be mailed to the taxpayer at any time not later than six
51 years after the return was filed. For purposes of this subdivision, there
52 shall not be taken into account any amount that is omitted from gross
53 income stated in the return if such amount is disclosed in the return or
54 in a statement attached to the return, in a manner adequate to apprise
55 the commissioner of the nature and amount of such item.

56 (4) In the case of a failure to disclose a listed transaction, as defined
57 in Section 6707A of the Internal Revenue Code, on the taxpayer's
58 federal income tax return, a notice of deficiency assessment may be
59 mailed to the taxpayer at any time not later than six years after the
60 return required under this chapter for the same income year was filed.

61 (b) (1) When it appears that any part of the deficiency for which a
62 deficiency assessment is made is due to negligence or intentional
63 disregard of the provisions of this part or regulations promulgated
64 thereunder, there shall be imposed a penalty equal to ten per cent of
65 the amount of such deficiency assessment, or fifty dollars, whichever is
66 greater. When it appears that any part of the deficiency for which a
67 deficiency assessment is made is due to fraud or intent to evade the
68 provisions of this part or regulations promulgated thereunder, there
69 shall be imposed a penalty equal to twenty-five per cent of the amount
70 of such deficiency assessment. When it appears that any part of the
71 deficiency for which a deficiency assessment is made pursuant to
72 section 12-233, as amended by this act, is due to failure to disclose a
73 listed transaction, as defined in Section 6707A of the Internal Revenue
74 Code of 1986, or any subsequent corresponding internal revenue code
75 of the United States, as from time to time amended, on the taxpayer's
76 federal tax return, there shall be imposed a penalty equal to seventy-
77 five per cent of the amount of such deficiency assessment.

78 (2) No taxpayer shall be subject to more than one penalty under this
79 section in relation to the same tax period.

80 (3) Any decision rendered by any federal court holding that a
81 taxpayer has filed a fraudulent return with the Director of Internal
82 Revenue shall subject the taxpayer to the penalty imposed by this
83 section without the necessity of further proof thereof, except when it
84 can be shown that the return to the state so differed from the return to
85 the federal government as to afford a reasonable presumption that the
86 attempt to defraud did not extend to the return to the state.

87 (c) [~~Within~~] Not later than thirty days [~~of~~] after the mailing of [~~such~~]
88 a notice of deficiency assessment, the taxpayer shall pay to the
89 commissioner, in cash or by check, draft or money order drawn to the
90 order of the Commissioner of Revenue Services, any additional
91 amount of tax shown to be due by [~~the corrected return or~~] such notice,
92 or such taxpayer shall be paid by the State Treasurer, upon order of the
93 Comptroller, any amount shown to be due it by [~~such~~] the corrected
94 return. The failure of the taxpayer to receive any timely mailed notice
95 required by this section shall not relieve [~~him~~] such taxpayer of the
96 obligation to pay the tax assessed under the terms of this part or any
97 interest or penalties thereon.

98 (d) When, before the expiration of the time prescribed in this section
99 for the examination of the return or the assessment of the tax, both the
100 commissioner and the taxpayer have consented in writing to such
101 examination or assessment after such time, the return may be
102 examined and the tax may be assessed at any time prior to the
103 expiration of the period agreed upon. The period so agreed upon may
104 be extended by subsequent agreements in writing made before the
105 expiration of the period previously agreed upon. The commissioner
106 may also in such a case waive the statute of limitations against a claim
107 for refund by such taxpayer.

108 (e) For purposes of this section, a tax return filed under this chapter
109 before the last day prescribed by law or by any regulation adopted
110 pursuant to this chapter for the filing of such return, determined
111 without regard to any extension of time for filing, shall be deemed to
112 be filed on such last day.

113 Sec. 3. Subsection (a) of section 12-728 of the general statutes is
114 repealed and the following is substituted in lieu thereof (*Effective from*
115 *passage and applicable to taxable years commencing on or after January 1,*
116 *2005*):

117 (a) (1) After a final return pursuant to the provisions of this chapter
118 is filed, the commissioner shall cause the same to be examined and
119 may make such further audit or investigation or reaudit as the
120 commissioner deems necessary, and if the commissioner determines
121 that there is a deficiency with respect to the payment of any tax due
122 under this chapter, the commissioner shall assess or reassess the
123 additional taxes, penalties and interest due to this state, give notice of
124 such assessment or reassessment to the taxpayer and make demand
125 upon the taxpayer for payment. [Within] Not later than sixty days [of]
126 after the mailing of such notice, the taxpayer shall pay to the
127 commissioner, in cash or by check, draft or money order drawn to the
128 order of the commissioner, the amount of the deficiency. Such amount
129 shall bear interest at the rate of one per cent per month or fraction
130 thereof from the date when the original tax became due and payable.

131 (2) When it appears that any part of the deficiency for which a
132 deficiency assessment is made is due to negligence or intentional
133 disregard of the provisions of this chapter or regulations adopted
134 thereunder, there shall be imposed a penalty equal to ten per cent of
135 the amount of such deficiency assessment. When it appears that any
136 part of the deficiency for which a deficiency assessment is made is due
137 to fraud or intent to evade the provisions of this chapter or regulations
138 adopted thereunder, there shall be imposed a penalty equal to
139 twenty-five per cent of the amount of such deficiency assessment.
140 When it appears that any part of the deficiency for which a deficiency
141 assessment is made is due to failure to disclose a listed transaction, as
142 defined in Section 6707A of the Internal Revenue Code of 1986, or any
143 subsequent corresponding internal revenue code of the United States,
144 as from time to time amended, on the taxpayer's federal tax return,
145 there shall be imposed a penalty equal to seventy-five per cent of the
146 amount of such deficiency assessment.

147 (3) No taxpayer shall be subject to more than one penalty under this
 148 section in relation to the same tax period.

149 (4) Any decision rendered by any federal court holding that a
 150 taxpayer has filed a fraudulent return with the Director of Internal
 151 Revenue shall subject the taxpayer to the twenty-five per cent penalty
 152 imposed by this subsection without the necessity of further proof
 153 thereof, except when it can be shown that the return to the state so
 154 differed from the return to the federal government as to afford a
 155 reasonable presumption that the attempt to defraud did not extend to
 156 the state.

157 Sec. 4. Subsection (c) of section 12-733 of the general statutes is
 158 repealed and the following is substituted in lieu thereof (*Effective from*
 159 *passage and applicable to taxable years commencing on or after January 1,*
 160 *2005*):

161 (c) (1) If no return is filed or if a taxpayer makes, wilfully or
 162 otherwise, a false or fraudulent return, a notice of deficiency
 163 assessment may be mailed to the taxpayer at any time.

164 (2) If a taxpayer wilfully attempts in any manner to defeat or evade
 165 a tax imposed by this chapter, a notice of deficiency assessment may be
 166 mailed to the taxpayer at any time.

167 (3) If a taxpayer fails to disclose a listed transaction, as defined in
 168 Section 6707A of the Internal Revenue Code, on the taxpayer's federal
 169 tax return, a notice of deficiency assessment may be mailed to the
 170 taxpayer at any time not later than six years after the return required
 171 under this chapter for the same taxable year was filed.

This act shall take effect as follows and shall amend the following sections:		
Section 1	<i>from passage and applicable to any open tax period</i>	New section

Sec. 2	<i>from passage and applicable to income years commencing on or after January 1, 2005</i>	12-233
Sec. 3	<i>from passage and applicable to taxable years commencing on or after January 1, 2005</i>	12-728(a)
Sec. 4	<i>from passage and applicable to taxable years commencing on or after January 1, 2005</i>	12-733(c)

FIN *Joint Favorable Subst.*

The following fiscal impact statement and bill analysis are prepared for the benefit of members of the General Assembly, solely for the purpose of information, summarization, and explanation, and do not represent the intent of the General Assembly or either House thereof for any purpose:

OFA Fiscal Note**State Impact:**

Agency Affected	Fund-Effect	FY 06 \$	FY 07 \$
Department of Revenue Services	GF - Revenue Gain	See Below	See Below

Note: GF=General Fund

Municipal Impact: None

Explanation

The bill is intended to act as a disincentive to promoters (tax preparers) and taxpayers to discourage them from using abusive tax transactions or failing to disclose listed transactions. The bill would result in a revenue gain to the extent that it improves the likelihood that taxpayers will accurately report their personal income and corporation business tax liability. The bill would also result in a revenue gain to the extent that the new 75% penalty is imposed on promoters and taxpayers resulting from the use of abusive tax transactions or failure to properly list transactions.

The amount of the revenue gain resulting from these two sources cannot be quantified due to the difficulties in predicting how promoters and taxpayers will react to the bill's provisions.

OLR Bill Analysis

sSB 1265

AN ACT CONCERNING PENALTIES FOR FAILURE TO REPORT LISTED TRANSACTIONS**SUMMARY:**

This bill establishes new and enhanced penalties to address abusive tax shelters. It:

1. imposes a penalty on promoters of tax shelters the Internal Revenue Service (IRS) lists as abusive ("listed transactions"), if their activities affect state tax returns; and
2. establishes a separate, higher penalty for corporation and personal income tax deficiencies attributable to a taxpayer's failure to disclose a listed transaction on his federal tax return.

The bill also extends certain deadlines for the Department of Revenue Services (DRS) to audit corporation and personal income tax returns and send tax deficiency assessment notices.

EFFECTIVE DATE: Upon passage. The penalty on tax shelter promoters is applicable to any open tax period. The remaining provisions are applicable to income years starting on or after January 1, 2005

PENALTY FOR ABUSIVE TAX SHELTER PROMOTERS (§ 1)

The bill imposes a new penalty on anyone who deliberately makes a material false statement in connection with organizing or selling an abusive tax shelter listed by the IRS ("listed transaction"), if the activities affect Connecticut tax returns. The penalty is 50% of the gross income the person derives or expects to derive from the activity. The false statement must relate to the allowability of any deduction, credit, income exclusion, or other tax benefit arising from participation in the listed transaction.

Federal law applies the same penalty for such activity (26 USC § 6700, as amended by P.L. 108-357, § 818). Under the bill, the state penalty applies to anyone subject to the federal penalty, even if no federal penalty is imposed.

CORPORATION AND PERSONAL INCOME TAX DEFICIENCY PENALTIES (§§ 2(b) (1) AND 3)

The bill establishes a new penalty of 75% of a tax deficiency assessment when any part of a tax deficiency is attributable to a taxpayer's failure to disclose a listed transaction on his federal return. Currently, there is no separate penalty for failure to disclose listed transactions. Instead, the penalties are (1) for deficiencies due to negligence or intentional disregard of state corporation or personal income tax laws or regulations, the greater of \$50 or 10% of the tax deficiency and (2) for those due to fraud or intentional evasion of tax laws or regulations, 25% of the deficiency assessment.

CORPORATION TAX DEFICIENCY ASSESSMENTS (§ 2(a), (e))

Audit and Tax Deficiency Assessment Deadline Extensions

The bill extends the time limits for DRS to audit corporation tax filings and send notices of deficiency assessments in certain cases and eliminates time limits entirely in others. In doing so, it makes the corporation tax audit and deficiency assessment requirements more closely match similar provisions of the personal income tax.

Under current law, the deficiency assessment deadline for returns showing no operating loss is three years after the return's due date or the date DRS receives it, whichever is later. The deadline for returns showing an operating loss is three years after the due date or receipt date, whichever is later, of the last return on which the loss carryover is fully utilized or deemed utilized.

The bill extends the time limit to six years when a company (1) omits more than 25% of properly includable gross income, unless the return itself or an attached statement adequately discloses the nature and amount of the omission or (2) fails to disclose a listed transaction on its federal tax return. The bill eliminates all deadlines for mailing deficiency assessments when (1) a company fails to file a required return or amended return reflecting federal tax adjustments or (2) the deficiency is the result of fraud or intentional evasion of the

corporation tax law or its regulations.

Deficiency Assessment Notice Timetable

The bill eliminates a current 30-day window between the time DRS discovers an error in a return and the time it must notify the taxpayer. Instead, it requires DRS to mail a deficiency assessment notice when it discovers a deficiency. If, no later than 60 days before the deadline for sending a deficiency assessment notice, the commissioner receives a written document signed by the taxpayer showing that the taxpayer owes additional taxes, the bill extends the deficiency assessment notice deadline to 60 days from the date DRS receives the document.

The bill specifies that, for purposes of determining deficiency assessment notice deadlines, a tax return filed before the final due date, excluding extensions, is considered filed on the due date.

PERSONAL INCOME TAX DEFICIENCY ASSESSMENTS (§ 4)

The bill increases the time limit, from three to six years, for DRS to send an income tax deficiency assessment notice to a taxpayer who fails to disclose a listed transaction on his federal tax return. A six-year time limit already applies when a taxpayer omits more than 25% of his includable Connecticut adjusted gross income from his return and fails to adequately explain the omission in the return or an attached statement.

The bill also allows DRS to send a deficiency assessment notice at any time to a taxpayer who willfully attempts to evade or defeat the state income tax law or regulations. Currently, there is no time limit on DRS deficiency assessment notices to taxpayers who (1) fail to file returns, (2) fail to file required amended returns reflecting federal tax changes, or (3) file false or fraudulent returns.

In all other situations, income tax deficiency assessment notices must be sent within three years.

BACKGROUND

IRS Listed Transactions

Federal law requires taxpayers to report their participation in listed transactions to the IRS on their federal corporation and income tax

returns. Listed transactions are those either specifically identified by the IRS as tax avoidance transactions or any transactions substantially similar to them. The IRS currently lists 31 such transactions. They include misuse of Roth IRAs by businesses, S corporations that do not benefit rank and file employees, improper life insurance arrangements for highly compensated employees, transactions involving distribution on encumbered property in which a taxpayer claims tax losses for capital outlays he has in fact recovered, and transactions generating losses from artificially inflating the cost basis of partnership interests. A complete roster of listed transactions is posted on the IRS website.

DRS Compliance Initiative

From June 16 to July 31, 2004, DRS offered taxpayers who participated in listed transactions affecting their Connecticut tax returns the opportunity to voluntarily disclose that fact to DRS and resolve their state tax liability without risking civil or criminal penalties. To take advantage of the amnesty, a taxpayer had to (1) concede 100% of any claimed artificial tax loss from a false basis adjustment or any other strategy to minimize gain and (2) pay interest on tax underpayments (DRS Announcement AN 2004(5), June 16, 2004).

COMMITTEE ACTION

Finance, Revenue and Bonding Committee

Joint Favorable Substitute

Yea 43 Nay 0